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SOCIAL IMPACT BONDS

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You asked for background information on social impact bonds. Specifically, you want to know (1) what they are, (2) their uses, (3) their benefits and drawbacks, and (4) which states are using them.

SUMMARY

A social impact bond (SIB) is a partnership between government, private investors, and nonprofit service providers to fund social programs. Under the SIB model, a government contracts with a private-sector organization to obtain social services. The organization acts as an intermediary between private investors, who provide the upfront capital to pay for the services, and nonprofit service providers, who actually deliver the services. The government pays the organization only if the program achieves predetermined performance outcomes.

While it is a relatively new concept, SIBs are being used or developed to finance social programs in the areas of chronic homelessness and criminal and juvenile justice. There have also been discussions of using SIBs in other areas, including education, workforce development, and caring for children with disabilities.

SIBs offer three major benefits. First, they provide a mechanism for a government to fund innovative social programs, while simultaneously shifting the financial risk to the private sector. Second, SIBs help the government pay for outcomes, rather than activities. Lastly, they reward service providers who create effective programs and otherwise have no way of scaling up their programs.

The primary drawback to SIBs is cost. Using a SIB to deliver a social program is potentially more complicated and expensive than if a government simply contracts directly with a service provider.

The first SIB program began in the United Kingdom in 2010. In the U.S., New York City and Massachusetts recently launched projects involving SIBs or similar initiatives. In Connecticut, a provision in [PA 12-2, June Special Session](#) (§ 128) authorizes the Office of Policy and Management secretary to enter into an “outcome-based performance contract,” comparable to a SIB, for the purpose of accepting specified federal Department of Justice funding for adult reentry programs. Some other states and municipalities have explored the possibility of using SIBs, such as Oregon.

Much of the information in this report is taken from two recent studies on SIBs, a May 2012 report by McKinsey & Company ([From Potential to Action: Bringing Social Impact Bonds to the U.S](#)) and a February 2012 report by Jeffrey Liebman at the Center for American Progress ([Social Impact Bonds: A Promising New Financing Model to Accelerate Social Innovation and Improve Government Performance](#)).

WHAT ARE SOCIAL IMPACT BONDS?

SIBs are not debt instruments, but rather a funding mechanism for social programs. Under a SIB, a government contracts with a private sector organization (an “intermediary”) to obtain social services. The intermediary raises capital from investors to pay for the services, contracts with nonprofit service providers to deliver them, and conducts ongoing program management during its implementation. The government pays the intermediary only if the program achieves predetermined performance outcomes. If it fails to achieve these outcomes, the government does not pay.

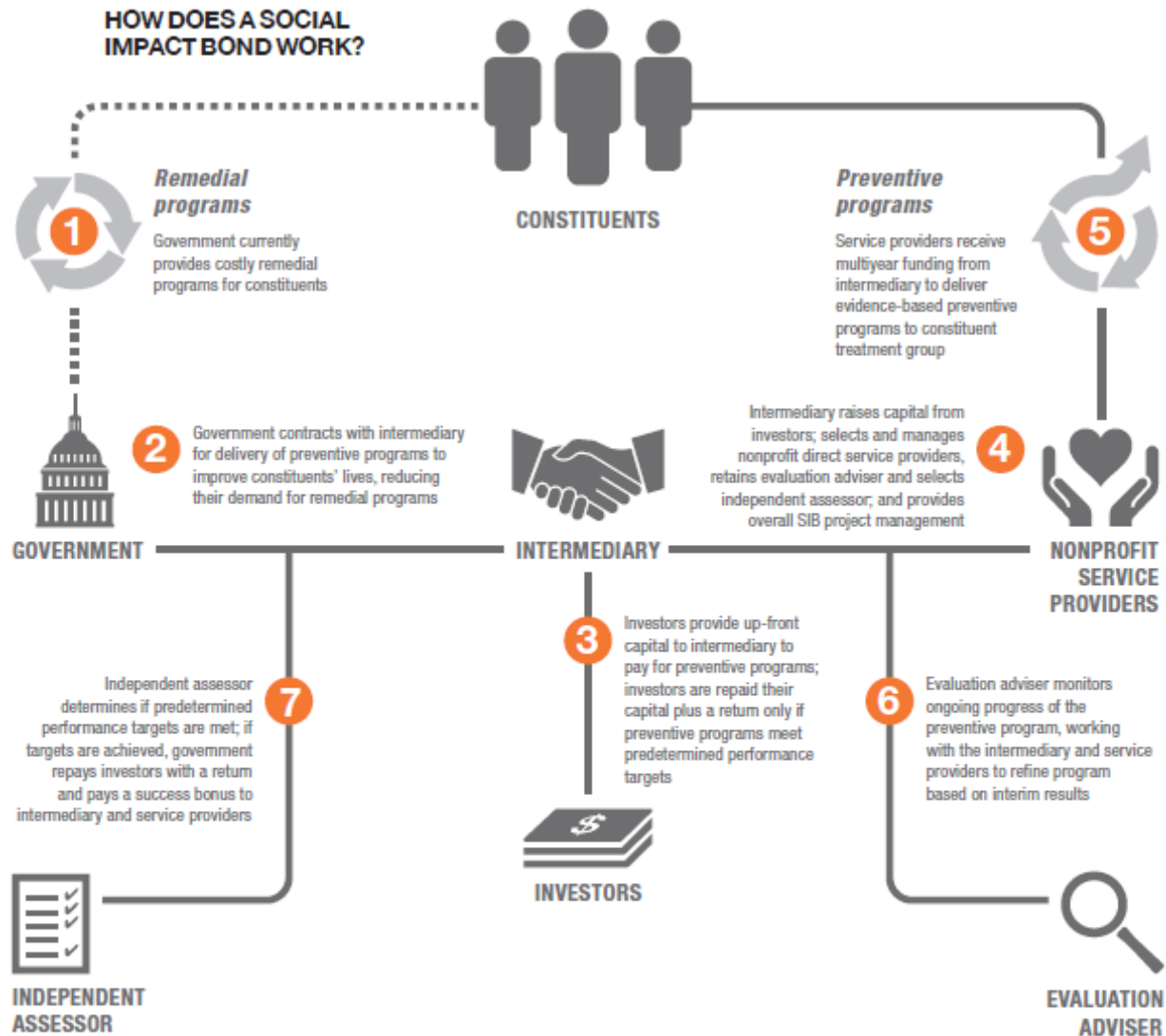
Private investors, including private foundations or other philanthropic groups, provide the upfront capital to pay for the services. They are repaid from a share of the government payments that become available

only if the performance targets are met. The intermediary uses this capital to pay nonprofit service providers. The providers also receive a bonus if they deliver the promised outcomes.

The intermediary employs an evaluation adviser to help monitor the program's performance and refine the program if needed. An independent assessor is also involved in setting and measuring the performance outcomes and ultimately determining whether, and how much, the government must pay the intermediary.

Figure 1 graphically depicts the relationships between the stakeholders involved in the SIB model.

Figure 1: Social Impact Bonds Model



Glossary of terms

Remedial services: Government programs that address negative social outcomes after they've occurred (e.g., incarceration for criminals, emergency room access for the chronically homeless).

Preventive interventions: Social service programs that focus on avoiding negative social outcomes (e.g., alternatives to incarceration, permanent supportive housing for the chronically homeless).

Constituent treatment group: Those individuals who benefit from the preventive intervention and whose results are compared to others who did not receive similar services.

Source: *From Potential to Action: Bringing Social Impact Bonds to the U.S.*, McKinsey & Company, May 2012 (<http://mckinseysociety.com/social-impact-bonds/>)

USES OF SIBS

To date, SIBs are being used or developed to finance social programs in the areas of chronic homelessness and criminal and juvenile justice. But there have also been discussions of using SIBs in other areas, including education, workforce development, and caring for children with disabilities.

The Center for American Progress report suggests that SIBs are generally best suited for projects that have (1) a potential for high net benefits to allow investors to earn their required rates of return, (2) measurable outcomes that are highly correlated with a program's overall social benefits, (3) a well-defined treatment population, (4) a reliable comparison (i.e., control) group, and (5) safeguards against harming the treatment population if the project does not succeed.

The report compiles the following list of social issues that experts have identified as “program areas most in need of social innovation,” but it does not analyze whether SIBs would be viable in these areas:

1. kindergarten readiness and third-grade reading skills in disadvantaged communities,
2. employment services for hard-to-employ groups,
3. health and disability-related interventions,
4. financial aid for students attending for-profit colleges, and
5. college retention services (pg. 27).

BENEFITS AND DRAWBACKS

SIBs offer three major benefits. First, they align the interests of governments, investors, and nonprofit service providers by providing a mechanism for piloting or expanding social programs, while also shielding the government from financial risk. As the McKinsey report notes, “SIBs can give structure to the critical handoff between philanthropy (the risk capital of social innovation) and government (the scale-up capital of social innovation) to bring evidence-based interventions to more people” (pg. 7).

Second, SIBs help the government pay for outcomes, rather than activities. This can help shift government resources from remediation programs to prevention services, thus reducing the need for expensive safety-net services. In addition, the oversight and program evaluation embedded in the SIB model help boost quality and performance and increase the likelihood that a program will be successful.

Lastly, SIBs reward service providers who create effective programs and otherwise have no way of scaling up their programs. SIBs provide a funding source for nonprofit organizations that have a strong track record of improving outcomes but have been unable to expand their operations through traditional funding streams.

The primary drawback to using SIBs is cost. The SIB model involves various stakeholders that charge a fee or expect a return on their investment. It also demands rigorous evaluation, which is costly. As a result, it is potentially a more complicated and expensive way to deliver programs than if a government contracts directly with a service provider. But these additional costs may be “justified if conventional options are not working, or if the SIB helps government, philanthropy, and other social sector actors align their priorities and play their roles more effectively and efficiently” (McKinsey, pg. 10).

EXAMPLES OF SOCIAL IMPACT BOND PROGRAMS

United Kingdom

According to the McKinsey report, the first SIB program began in September 2010 by Social Finance UK, a nongovernmental organization that helps finance social service organizations. Social Finance UK raised money from philanthropic funders before starting the program.

The program was designed to rehabilitate prisoners at Peterborough Prison, by such things as increasing education and vocational skills. It is being implemented by four nonprofit organizations. Investors’ return on investment will vary based on the recidivism rates among program participants, ranging from a profit of up to 13.5% to losing their entire investment.

Massachusetts

In July 2012, Massachusetts passed legislation, as part of the state budget process, creating a mechanism for Social Innovation Financing, through which the secretary of administration and finance can enter into “pay for success contracts.” The legislation (2012 Mass. Acts, Chapter 143, codified at Mass. Gen. Laws ch. 10, § 35vv) created a trust fund to pay for the program.

Among other things, the contracts must include (1) a requirement that a substantial portion of the payment be conditioned on achieving specific outcomes based on defined performance targets; (2) the calculation of payments the service provider will earn if it achieves those

targets, based on an objective, independent evaluation process; and (3) the secretary's determination that the contract will result in significant performance improvements and budgetary savings across all impacted agencies if the performance targets are achieved. The legislation limits the total amount of government-secured payments under the program to \$50 million.

According to a state [press release](#), Massachusetts is the first state to issue a competitive procurement process for a pay for success program in this manner. Massachusetts launched the program to address chronic homelessness and juvenile justice. The homelessness initiative's goal is to provide stable housing for chronically homeless people while reducing expenses for emergency shelter and Medicaid. The juvenile justice initiative is designed to reduce recidivism and improve education and employment outcomes for youth leaving the juvenile justice system or probation.

For more information on the program, such as the agencies chosen as intermediaries for the contracts, see the press release.

New York City

In 2012, New York City launched the nation's first SIB program. According to a [New York Times article](#), Goldman Sachs will loan \$9.6 million to pay MRDC, a social services provider, for a four-year program designed to reduce recidivism by at least 10% among adolescent males released from incarceration at Rikers Island. MRDC will oversee the program, which will be run by two nonprofit institutions.

According to the article, Goldman's return on the investment will vary based on how well the program reduces recidivism. The firm will (1) lose up to \$2.4 million if recidivism does not drop by at least 10%, (2) be repaid the \$9.6 million if the program reaches the 10% target, or (3) profit up to \$2.1 million if the program succeeds beyond the target.

Mayor Bloomberg's personal foundation, Bloomberg Philanthropies, will provide a \$7.2 million loan guarantee to MRDC. If MRDC meets its target, the city will pay Goldman, and MRDC can use the loan guarantee to pay for other SIBs. If MRDC does not meet its target, it can use the loan guarantee to repay Goldman.

More information about the program is available in this [fact sheet](#) on the city's website.

HYPERLINKS

From Potential to Action: Bringing Social Impact Bonds to the U.S., McKinsey & Company, May 2012 (<http://mckinseysociety.com/social-impact-bonds/>)

Social Impact Bonds: A Promising New Financing Model to Accelerate Social Innovation and Improve Government Performance, Center for American Progress, February 2011
(http://www.americanprogress.org/wp-content/uploads/issues/2011/02/pdf/social_impact_bonds.pdf)

“Massachusetts First State in the Nation to Announce Initial Successful Bidders for ‘Pay for Success’ Contracts,” August 1, 2012
(<http://www.mass.gov/anf/press-releases/fy2013/massachusetts-first-state-in-the-nation-to-announce-ini.html>)

“Goldman to Invest in City Jail Program, Profiting if Recidivism Falls Sharply,” *New York Times*, August 2, 2012
(http://www.nytimes.com/2012/08/02/nyregion/goldman-to-invest-in-new-york-city-jail-program.html?_r=0)

“Fact Sheet: The NYC ABLE Project for Incarcerated Youth: America’s First Social Impact Bond,” August 2, 2012
(http://www.nyc.gov/html/om/pdf/2012/sib_fact_sheet.pdf)

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